No. 87-1064

In The
Supreme Court of the United States
October Term, 1988

UNITED STATES OF AMERICA,

Petitioner,

v.

PHILIP GEORGE STUART, SR., AND MONS KAPOOR,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

SUPPLEMENTAL BRIEF OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—(Continued)

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INTRODUCTION

This supplemental brief of additional authorities is submitted on behalf of respondents Philip George Stuart, Sr. and Mons Kapoor, pursuant to Rule 35.5 of the Rules of the Supreme Court of the United States.

The principal purpose of this supplemental brief is to bring to the Court's attention a very recent article about

this specific case and the Ninth Circuit's opinion below, authored by Martin H. Scheim and James Cantillon Rose, "*Stuart v. United States:* Standards for Section 7602 Summons in Treaty Matters," 17 *Tax Mngm't Int'l Journal*, No. 11, at 479 (BNA, November 11, 1988). The authors cite and quote extensively from relevant portions of the *Taxation Operations Manual, Special Investigations*, §§ 11(1)7.2(2)(E), *et seq.*, of the Department of Revenue Canada ("Revenue Canada"), and from other pertinent tax cooperation treaties between the United States and Canada, including the *Treaty Between the Government of the United States of America and the Government of Canada on Mutual Legal Assistance in Criminal Matters*, signed at Quebec City on March 18, 1985; pending ratification by the United States Senate, United States Senate Treaty Document, 100-14 ("The 1985 Criminal Assistance Treaty"). Respondents respectfully submit that these new authorities further support and supplement the arguments contained in the Brief of Respondents in support of the Ninth Circuit's opinion in *Stuart v. United States*, 813 F.2d 243 (9th Cir. 1987).

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ISSUE ON REVIEW

Whether, when requesting court enforcement of an IRS administrative summons under the provisions of Section 7602(a) of the Internal Revenue Code, where the IRS summons was issued to obtain information for a foreign government under the terms of a tax treaty which specifically defers to the revenue laws of the United States, the

IRS should be required to make a *prima facie* showing that the summons was issued for a legitimate purpose, including the absence of a criminal prosecution purpose.

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SUMMARY OF ARGUMENT

The tax article cited by respondents, Scheim and Rose, "*Stuart v. United States:* Standards for Section 7602 Summons in Treaty Matters," 17 *Tax Mngm't Int'l Journal* No. 11, at 479 (BNA, November 11, 1988), provides an insightful analysis into the requirements for an administrative summons issued by the IRS pursuant to Internal Revenue Code Section 7602 (26 U.S.C. § 7602) in response to a request by a treaty partner for information. The practice of the revenue departments of the treaty parties set forth in the article is consistent with the Ninth Circuit's opinion in *Stuart v. United States*, 813 F.2d 243 (9th Cir. 1987), and illuminates the treaty partners' evident intent as manifested by their operating guidelines in making treaty requests, and in their subsequent negotiation of a separate treaty to overcome the limitations of the 1942 and 1980 tax treaties. Further, their practice provides for the consistent treatment of Section 7602(a) enforcement requests in both domestic and treaty cases.

In construing the requirements for an administrative summons pursuant to a treaty request of a foreign government, the courts are guided not only by the treaty language, but also by the practices of the governments involved in applying the treaty. Under the particular treaty involved here, the practice of Revenue Canada, as reflected

in its *Taxation Operations Manual, Special Investigations* § 11(11)7.2(2)(E), *et seq.*, is to refrain from making treaty requests for the exchange of information if there has been a referral by Revenue Canada to the Canadian Department of Justice. This practice recognizes the inability of the IRS to issue a thirty-party summons if Revenue Canada has referred the case for criminal prosecution. Thus, the requirements for a *prima facie* showing set forth by the Ninth Circuit in *Stuart v. United States*, 813 F.2d at 249, are entirely consistent with the practice of the Revenue Services of the two nations under the specific treaty at issue.

The *prima facie* showing required by the Ninth Circuit in its opinion below is also consistent with the obvious intent and purpose of the more recent *Treaty Between the Government of the United States of America and the Government of Canada on Mutual Legal Assistance in Criminal Matters*, signed at Quebec City on March 18, 1985; United States Senate Document 100-14 ("The 1985 Criminal Assistance Treaty"). In implicit recognition of the criminal referral limitation on the exchange of information under the 1942 (and 1980) Treaty, the 1985 Criminal Assistance treaty provides for the direct exchange of information between the Canadian and United States governments in pending *criminal* matters. Limitations on the exchange of information under the 1942 or 1980 United States-Canada Tax Treaties imposed by Section 7602, when the matter has been referred for criminal prosecution in either country, will be handled in accordance with the new procedures established under the 1985 Criminal Assistance Treaty.

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ARGUMENT

The recent article about this case and the Ninth Circuit's opinion below, by Scheim and Rose, "*Stuart v. United States:* Standards for Section 7602 Summons in Treaty Matters," 17 *Tax Mngm't Int'l Journal* No. 11, at 479 (BNA, November 1, 1988) (hereinafter "the Article"), points out that the existence of a practice on the part of the Canadian and United States governments which corresponds to the *prima facie* showing requirements established by the Ninth Circuit is highly relevant to the construction of the 1942 Treaty at issue here (1942 Canada-United States Income Tax Convention, Articles XIX and XXI). Recognition of the practice of the parties comports with fundamental principles of treaty construction, *TransWorld Airlines, Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 260 (1984), and with the terms of the Vienna Convention on the Law of Treaties.[1] Article 31(3)(b) of the Vienna Treaty provides that, in construing the terms of a treaty, the parties shall take into account, in addition to the context, any practice followed in the application of the treaty which establishes the agreement of the parties as to the construction of the treaty.

The extent of the limitations arising from the application of United States domestic "revenue laws" in the 1942 Treaty should be determined in the present case by reference to the parties' practices recognizing the limitations imposed on the summons power of the IRS under Section 7602.

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[1]The Vienna Convention on the Law of Treaties has been signed by both the United States and Canada, although only Canada has ratified it to date. The principles reflected in the Treaty, however, are generally accepted as representing customary international law in the interpretation of treaties. 17 *Tax Mngm't Int'l Journal*, No. 11, at 481 (BNA, November 11, 1988).

I. Canadian Tax Investigatory Practices Recognize the Limitation on IRS Summons Powers Under Section 7602 When a Case Has Been Referred for Criminal Prosecution

The authors of the article, *supra*, point out that Revenue Canada's Special Investigations Section Manual entitled *Taxation Operations Manual, Special Investigations* specifically recognizes and accommodates the limitations placed on the summons power of the IRS pursuant to Section 7602:

> In a section on exchange of information under the Treaty, *the Manual notes that the IRS will not issue a third-party summons if the Department has referred its case to Justice. In consequence, the investigator is instructed to ensure that he has obtained all information under the Treaty requiring a summons before referring the case to Justice* [Taxation Operations Manual, Special Investigations, § 11(11) 7.2(2)(E).]

(Emphasis added.) 17 *Tax Mngm't Int'l Journal*, No. 11, at 482.

The above-quoted provisions of the *Taxation Operations Manual, Special Investigations*, make clear that Revenue Canada's own internal procedures and practices: (1) recognize that access to information is denied to the IRS under United States revenue law if there has been a referral for criminal prosecution; and (2) accommodates these limitations imposed by United States revenue law (Section 7602) by making no request of the IRS for the exchange of information after referral to the Canadian Department of Justice for criminal prosecution. The IRS defers to Canadian law when making requests of Revenue Canada under the treaty. *Cf. United States v. A.L. Burbank & Co., Ltd.*, 525 F.2d 9, 14-15 (2d Cir. 1975), *cert. denied*, 426 U.S. 934 (1976); Internal Revenue Manual § 9265.2(2) (1983) (IRS should provide adequate background to support a simultaneous Canadian tax interest because Canadian tax authorities are authorized to furnish only that information which they can obtain under the revenue laws of Canada).

The practices of both governments under the 1942 Treaty assume that if information requested of the other government under the treaty is not available to the requested tax authority under its own domestic laws, it cannot be made available to the requesting government. The Canadian taxing authority recognizes that under the United States domestic revenue laws, the IRS may not obtain enforcement of an administrative summons after a referral of a domestic case for prosecution and, accordingly, that a referral for criminal prosecution in Canada bars a treaty request for information from the IRS.

In the opinion below, *Stuart v. United States*, 813 F.2d 243, 249 (9th Cir. 1987), the Ninth Circuit's formulation of a two-part test necessary to a *prima facie* showing parallels Revenue Canada's view of the limitations upon requests for information available under our domestic revenue laws, and therefore imposes no additional burden on the Canadian government. It does not interfere in any way in its internal governmental affairs, and is in keeping with the existing practice and procedure of Revenue Canada in its interpretation of the 1942 Treaty. The "revenue laws" of the United States, specifically deferred to by the language of the treaty, do not permit IRS access to information pursuant to Section 7602 in a domestic

case unless there is, in fact, an absence of a criminal prosecution referral, 26 U.S.C. § 7602(c), and, therefore, a "legitimate purpose." There is no justification in practice or in the language of the treaty for a difference in procedure between domestic and treaty cases. Without responses to the two-part test set forth by the Ninth Circuit, the IRS—and therefore the Canadian government—has failed to make out even a *prima facie* showing for court enforcement of its administrative summonses in the present cases.

II. The 1985 Treaty on Mutual Legal Assistance in Criminal Matters Evidences the Treaty Partners' Intent to Fill the Void Left by Civil Income Tax Liability Exchange Provisions of the 1942 (and 1980) Treaty.

Further evidence, consistent with the construction given by the Ninth Circuit in *Stuart v. United States, supra,* that the United States and Canadian governments did not intend that the 1942 (and 1980) United States-Canada Income Tax Treaty be used for the sole purpose of criminal prosecution is the negotiation and signing of a new treaty in 1985. The *Treaty Between the Government of the United States of America and the Government of Canada on Mutual Legal Assistance in Criminal Matters*[2] ("the 1985 Criminal Assistance Treaty") provides an additional framework for cooperative efforts by the Canadian and United States governments with respect to the *criminal*

[2]The 1985 Treaty was signed by the United States and Canada on March 18, 1985, in Quebec City, Quebec, Canada. The 1985 Treaty awaits United States Senate ratification. *See* United States Senate Treaty Document, 100-14.

enforcement of tax laws. The 1985 Treaty provides for mutual legal assistance in all matters relating to the investigation, prosecution and suppression of "offences." The 1985 Criminal Assistance Treaty, Article II(1). Although comparable in many respects to the 1942 and 1980 United States-Canada Income Tax Treaties, the 1985 Treaty differs principally in that it deals specifically with ongoing investigations and prosecutions of *criminal* matters, and provides for exchange of information directly between the United States Attorney General and Canadian Minister of Justice ("the Central Authorities"). The 1985 Criminal Assistance Treaty, Article I.

The article, *supra*, discusses the importance of the 1985 Criminal Assistance Treaty in filling the gap in information-gathering created by Section 7602:

> The 1985 Treaty expressly provides that the Parties may provide assistance pursuant to agreements other than the 1985 Treaty. [1985 Treaty, Article III(1).] *The implication therefore is that the Parties may use the 1985 Treaty instead of the other agreement if this is more appropriate or convenient. In this sense, the 1985 Treaty would be available to the two countries in tax matters in cases where the file has already been referred by the tax authority to the requesting State's Department of Justice for prosecution* and therefore is no longer in the hands of the competent authority as defined under the Tax Treaty.

(Emphasis added.) 17 *Tax Mngm't Int'l Journal*, No. 11, at 485 (BNA, November 11, 1988).

The 1985 Criminal Assistance Treaty fills the gap left by the 1942 (and 1980) Income Tax Treaties insofar as their information exchange provisions are limited by

the restrictive terms of Section 7602 for enforcement. Since, under Section 7602(c), the IRS cannot obtain information by an administrative summons after referral for criminal prosecution, and because this limitation is expressly incorporated in Articles XIX and XXI of the 1942 Treaty (and 1980 Treaty) by use of the term "revenue laws," it must be concluded that the 1985 Treaty was intended to provide information exchange powers broader than those contemplated by the civil tax liability purposes of the 1942 and 1980 Treaties, but subject to the appropriate protections applicable in criminal matters.

The holding and reasoning of the Ninth Circuit in these consolidated cases, making a clear distinction between civil revenue cases and criminal prosecution cases, whether arising from treaty requests or domestically, are supported by the negotiation and signing of the 1985 Treaty. That treaty is an acknowledgment of the importance of the dichotomy between civil and criminal matters and procedures.

Where, as here, the IRS requests court enforcement of its administrative summons under the provisions of the 1942 or 1980 civil tax treaties, the *prima facie* showing requirements of the Ninth Circuit, including the absence of a criminal prosecution purpose, reflect the intent and practice of the treaty partners. The Ninth Circuit's approach is a reasonable interpretation of the language and intent of the treaties; it does not interfere in the internal affairs of Canada; it maintains the important distinction between civil and criminal matters; it adequately accommodates the interplay between United States "revenue laws" (i.e., Section 7602) and the underlying purposes of

the treaties; and is consistent with the apparent intent of the 1985 Criminal Assistance Treaty.

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CONCLUSION

The judgment of the court of appeals should be affirmed in its entirety.

Respectfully submitted,

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